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Banking Evolution

AN ADDRESS

delivered by Charles H. Sabin, President of the Guaranty Trust Company of New York, before the State Bank Section of the American Bankers' Association in convention at Chicago, Ill., Sept. 25, 1918

NEW conditions require new systems. Change is the mark of progress. Our financial system, like any living organism, fulfills its function through growth. So, to-day, as bankers charged with responsibility in the furtherance and guidance of that growth, we should properly give consideration to the problems and opportunities it presents. From every angle this growth should be studied, and its possibilities for good and evil measured.

From the viewpoint of state banking, national banking, and international banking, there are prospects and tendencies which demand analysis and understanding. My thought in discussing the subject to which I have been invited to respond, is not so much to present conclusions, as, if possible, to stimulate thought and imagination. I assume that if these qualities are aroused in all of us, and our minds are alert to the signs of the times, decision and action will follow in due course.

Eighteen months ago the United States entered the world war. Unprepared as we were for war, it has been a stupendous task to adjust our industries to a war basis, but now, as always in our history when we have been confronted with a great crisis, we have risen to the occasion, with the result that today there is a fully-equipped army of more than 2,000,000 Americans in the field rendering effective service.

To accomplish such a result it has been necessary to conserve and coördinate our economic resources; to speed up production to a point that formerly seemed impossible; to solve transportation problems, and to engage in financial operations of greater magnitude than the world had ever known before.

The Lessons of War

War has taught us many lessons, but probably the most beneficial is the knowledge it has given us of the value of coöperation. Personal interests have been subserved to the one great purpose of winning the war, and this has been true particularly in the field of finance. Bankers have coöperated among themselves, with the Government, and with the public, with the result that the Government has been enabled to raise approximately $14,000,000,000 from taxation and the sale of Liberty Bonds, without serious disturbance of the money market.

To meet the demands of war and the demands of peace every possible step toward strengthening our financial system and increasing the efficiency of its operation should be taken. In considering any changes due care must be taken to assure ourselves that some loss may not offset the proposed gain. For instance, in the logical expansion of national banking, it is most essential that the rights and functions of State institutions be not harmfully disturbed. At least until that time in our financial progress has been reached when a thoroughly comprehensive and centralized banking system has been thought out and worked out, the rights of all classes of banks must be zealously guarded and no encroachments on those rights in behalf of any special interest permitted.

Mindful of this necessity an important conference of representatives of State banks was held at St. Louis on July 15th last. Out of this gathering an organization was effected representing at the start thirty States, with coöperation as its keynote, for the purpose of conserving and protecting those local privileges and interests which have been developed and become inherent in State financial institutions. It was the outcome of a realization of the necessity for the fullest extension of the service of both the National and State Bank Systems, and its intention is to coöperate with National banks and the Federal Reserve Board to promote safe and sound banking, to assist in financing the war, in developing our natural resources, and in extending our commerce.

State Banking History

Since the beginning of our history as a nation, State banking has been an important element in our financial system, and on many occasions it was the only banking system. It has had many vicissitudes, but it has weathered all storms and is today stronger than ever before. This is undoubtedly the result

of the special services that have been rendered by State banks, because of their adaptability to local needs. In some localities they have performed the functions of savings banks; in others they have catered to the agricultural needs of the community; trust companies have acted in a fiduciary capacity and in financial centres have exercised the functions of investment banks. Such services could not have been rendered by National banks on account of legal restrictions, and even with enlarged powers under the Federal Reserve Act, they are unable to respond to the needs of many communities.

In 1860, prior to the enactment of the National Bank Act, there were 1,562 State and private banks in the United States. In those days one of the principal functions of State banks was, of course, the issuance of currency, but under the National Bank Act a 10 per cent. tax was imposed on State banks with the result that many of them took out National charters, and in 1868 there were only 247 banks outside the National System. About 1870, however, State and private banks commenced to increase in number, and in 1877 there were 3,270, which further increased to 10,184 in 1900.

State Banks Have Increased Rapidly

In 1914, before the Federal Reserve Act went into operation, there were 19,240 State banks, trust companies, savings banks, and private banks, with total resources of about $15,500,000,000; and 7,538 National banks with total resources of about $11,500,000,000. Latest statistics show that there are now 20,423 banking institutions under State control with total resources of over $22,000,000,000 and 7,688 National banks with total resources of over $18,000,000,000. Since the Federal Reserve Act was passed the total resources of National banks show a larger percentage of increase than that of State institutions, but in number the latter have increased more rapidly.

Since the days when Alexander Hamilton in the Federalist so ably presented his propaganda for centralized banking and Federal power down through the reaction against the Central Bank led by Andrew Jackson, we have witnessed the conflict of these two ideas, and to-day we face a dual system of banking which carries with it elements of weakness as well as of strength. To eliminate as far as possible these weaknesses and increase the strength and real capacity for service of our financial institutions is our problem.

Increase of banking power during the war is undoubtedly an important part of the mobilization of our economic resources, and in a recent message to the banks of the country pointing out the imperative necessity for such action, President Wilson said:

"The banking problem involved is one that concerns all banks alike. Its solution does not depend upon the National banks alone, nor upon the State banks. The burden and the privilege must be shared by every banking institution in the country."

State bankers realize as fully as others the necessity for concerted action, and are serving their country by assisting business in their communities, by selling Liberty Bonds and War Savings Stamps, and by subscribing to Government Certificates of Indebtedness.

Concentration of Resources

Concentration of our banking resources in the Federal Reserve System has been invaluable in enabling us to undertake the financial operations essential to the war, and still further to strengthen the System, a vigorous campaign has been conducted to induce State banks to join. In this connection, however, public statements have been made that seem to me to be unfortunate in that they are not only misleading, but tend rather to retard than bring about the concentration that is desired. For instance, the Comptroller of the Currency recently issued a statement that for the first seven months in 1918 there was not a single National bank failure in the United States, whereas in the same time twenty-two State banks and trust companies in fourteen different States have failed.

State bankers naturally resent an incomplete statement of that kind, as tending to discredit State institutions, and injure their standing. No accurate statistics of State bank failures are available, but reference to the files of the American Banker, which gives a weekly list of closed banks, shows since the beginning of the year, fourteen State banks and trust companies, with total resources of about $3,500,000, and five State banks and three private banks, whose resources are not given in the Bankers' Encyclopedia, failed. It is doubtful if the total resources of all defunct State banks and trust companies amount to more than $5,000,000, or more than .02 per cent. of the total resources of State institutions. In forty-four States at least there have been no State bank failures, and in many of these States the strength of the State institutions is quite on a par with that of the National banks. It seems quite unfair and damaging to them to have such general reflections cast upon them by a Government official. The service which State

banks are rendering the nation seems to me to warrant greater consideration. Just as an indication of this service, I may be permitted to point with pride to the fact that a State chartered institution has led the country in subscriptions to the last two Liberty Loans. These are certainly days in which it is fitting to encourage harmonious coöperation among *all* banks to meet the nation's needs.

Although we have evidence daily that the patriotism of State banks is just as ardent as that of National banks, lack of patriotism has at times been imputed to State banks that have not joined the Federal Reserve System. Some recent public utterances urging membership in the System have implied that there are about 20,000 State banks which, through prejudice or selfishness, refuse to ally themselves with it. As membership in the System depends on many considerations, it is obviously unfair to attribute it to lack of patriotism, without a full knowledge of all the facts in each case.

Out of the 20,423 State institutions in the United States, only about 8,000 are eligible for membership in the System according to the Federal Reserve Board, so we have over 12,000 banks that could not join even if they would. Some of these banks have indicated that they would join if it could be done without increasing their capital, as increased capital would be a basis only for increased taxation, without being of any use in their business; but under the Act there can be no departure from the requirement that member State banks must have the same minimum capital as National banks, in the same localities, are required to have.

State Banks in the System

All National banks are, of course, members of the Federal Reserve System, and of the 8,000 State institutions said to be eligible, 752, including some of the largest State banks and trust companies,have become members, with the result that the System now controls about 70 per cent. of the total banking resources of the country.

Of the other eligible State banks many cannot join because of restrictions in State laws, and in other cases membership would entail changes in business that would be impracticable. A bank may have sufficient capital to make it eligible, but even then membership might not be desirable for either the bank or the System. This is emphasized in an article contributed to on June, 1918, number of "Trust Companies" by H. Parker Willis, former Secretary of the Federal Reserve Board, in which he says:

"The real question is two-sided—whether the State banker can be serviceable to the Federal Reserve System and whether the System can be serviceable to him. It is the essence of a good bargain that both parties shall be pleased. Unless the State institutions find that there is real benefit in membership, they will not continue very long as members; and unless the Federal Reserve System finds that they are a genuine source of strength to-day, rather than a source of weakness, they will not be very welcome members. How can these two requirements be fulfilled? The answer to this question affords the solution of the problem involved in the future relations between the Federal Reserve System and the State institutions."

After pointing out that only banks doing a commercial business can benefit either the System or themselves, he adds: "All this means that it is more important that State institutions should become active, participating members in the System than it is that they should merely join it in a technical and proforma way."

Why State Banks Enter the System

State institutions that can enter the System to their mutual advantage are becoming members. As was announced at the time the Guaranty Trust Company became a member, we were impelled not only by patriotic motives, but by the fact that practically every serious objection on our part to membership had been removed by the amendments to the Federal Reserve Act of June 20, 1917. The reasons that actuated us are not, however, necessarily applicable to all State institutions. Many of them enjoy privileges under State laws and perform necessary functions that have no relation to commercial banking, and as the Federal Reserve System is essentially a commercial system, there is not, and cannot be a place in it for them. Their rights and privileges, however, should be respected.

The Federal Reserve Act is considered by many to be the last word in banking legislation, and the final solution of all our financial ills. Even an authority like Sir Edward H. Holden of the London City and Midland Bank of London, England, said: "The United States has built up a banking system which surpasses in strength and excellence any other banking system in the world."

It has undoubtedly functioned, and is functioning, well in these abnormal times, and since its operations were commenced in 1914 bankers have enjoyed many privileges that were formerly denied to them; but there is still room for development, and

I believe that our Federal Reserve System is but the beginning of an evolution in banking that will eventually give us a single, uniform and unified banking system. That may be a far distant ideal, but I believe it is worth cherishing.

Functions of Banking

The functions of banking are to act as an intermediary in bringing together capital, and employing it where it can be most useful in industrial development; and also to facilitate the current exchange of commodities. The latter function is exercised by commercial banks, but to give effect to the former, there is in existence a great variety of financial institutions.

If all the banks in the country were to organize under the National Bank Act, we would be faced with immediate financial chaos, for a great deal of business that is offered to National banks must be refused on account of the legal restrictions on their operations. National banks have wider powers under the Federal Reserve Act than before, but they cannot exercise the functions of investment banks such as dealing in stocks and bonds, or the functions of mortgage banks in the same manner as trust companies, savings banks and savings and loan associations.

Such powers were denied to National banks because it was considered unsafe to combine commercial banking with any other type, but the operations that are being performed by our large trust companies prove that a combination of commercial, investment, and mortgage banking is not necessarily dangerous. Under the Federal Reserve Act, National banks have been authorized to exercise trust powers, and to act as insurance agents, neither of which are even incidental to banking, but they are prohibited from dealing in stocks and bonds,—financial operations of the first magnitude on which our whole industrial structure is based. Until we have a broad Federal Bank Act, authorizing banks under proper restrictions to engage in all kinds of financial operations, we cannot have complete concentration and mobilization of our banking resources.

In England, banks are organized under the General Companies Act, and the principal restriction on what a banker can do is his own good judgment as a banker. The restrictions imposed by our State and National banking laws have resulted in benefits to bankers and depositors alike, but restrictions should be on the manner of *exercising* banking functions, and not on the functions themselves. If we make that our policy, there is apparently no good reason for restricting the financial operations of our banks.

That tendency was evident in the Federal Reserve Act, but the widening of National bank powers was not so much a matter of policy as it was the result of expediency and compromise.

The Phelan Bill

Under Section 11-K of the Federal Reserve Act, the Federal Reserve Board has power to "grant by special permit to national banks applying therefor, when not in contravention of state or local laws, the right to act as trustee, executor or administrator, or registrar of stocks and bonds."

As the Act now stands, limitations and restrictions upon the exercise of trust powers are prescribed by regulations of the Federal Reserve Board. In the so-called Phelan Bill now before Congress certain restrictions and regulations are written into the Federal Reserve Act, which are intended, in general, to place upon National banks the restrictions imposed upon State institutions exercising fiduciary powers. In this respect the Phelan Bill is a distinct improvement over the present provisions of this section. The bill, however, contains the further provisions that the Federal Reserve Board may confer upon National banks the right to exercise fiduciary powers in States where trust companies are permitted to engage in commercial banking, even though the conferring of such powers be in contravention of State law. The argument is made in favor of this amendment that, since trust companies doing a commercial banking business are directly competing with National banks, National banks should be given an opportunity to obtain the same advantages in the exercise of fiduciary powers that are enjoyed by their competitors. On the other hand, the conferring of such fiduciary powers has always been a function of the State. Where a State expressly consents to or does not prohibit the conferring of such powers upon a National bank, it cannot seriously complain that its jurisdiction has been infringed; but it has been felt by many State institutions and State banking officials, that, although it was proper that such powers be conferred by the Federal Reserve Board with the consent of the State, it was a serious infringement upon the rights of the States to provide that such powers might be conferred even though in contravention of the State law. The time does not appear to have been reached when State autonomy in such matters can be sacrificed without loss.

The Federal Government has supervision of all international and interstate commerce, and it should also have control of national and international banking, but there would be no advantage under our present system to anyone in having purely local organizations like many of our State institutions organized under National laws. Their functions are exercised in a restricted territory, and they can be better and more easily supervised by the State authorities. Under Federal laws all our banks would have the same privileges and be subject to the same restrictions, and by this means the lack of uniformity in our banking laws would be eliminated. To a certain extent this might seem like a usurpation of State rights by the Federal Government, but it would only be an extension of the powers already possessed through the National Bank Act and the Federal Reserve Act; and the increased strength of our banking system that would result would be ample justification for it.

The Treasury System

In a system such as I have outlined, there would be no place for the Independent Treasury System, which, it is generally conceded, has outgrown its usefulness. The Federal Reserve Banks would be the fiscal agents of the Government, and we would not again be subject to the money market disturbances that were caused by the deposit and withdrawal of enormous sums without regard to the demands of trade. Of course, in recent years the bulk of Government funds has been kept on deposit in the banks, but the Secretary of the Treasury still has the power of influencing the money market by depositing or withdrawing public funds at his discretion. This power which is equivalent to regulating rates for money should not be vested in a Government official, but should, in my judgment, belong to the Federal Reserve Board.

This is, of course, not the time for drastic changes in our banking system, for until the war is won, all our efforts must be devoted to that end. Bankers who can strengthen the Federal Reserve System during the war will unhesitatingly do so, and those whose place is outside the System will not be lacking in devotion to the cause. When peace, such as we are contending for, is obtained, changes will be inevitable, for there will then be greater need than ever for coöperation among bankers, and complete mobilization of our banking resources, to enable us to retain the financial and commercial supremacy that we have now achieved.

Concentrating Credit

To meet the new conditions presented in world trade, the desirability of concentrating banking credit has appealed to the bankers of other countries, and offers its possible suggestion to us. For instance, in England, as a result of such amalgamations, the leading banks now show these huge deposits:

London City and Midland	$1,570,000,000
Lloyds	1,500,000,000
London County, Westminster & Parr's	1,250,000,000
Barclay's	1,100,000,000
Union of England and Smith's	900,000,000

English bankers and business men believe that, in order for them to compete effectively for the world's trade with other countries, this concentration of credit and the extension of branch-banking are necessary steps. Without banking leadership foreign trade cannot be commanded. The effective use of such powers by Germany has taught this lesson. The German banks trading abroad not only were useful financial institutions, but acted as information bureaus for their countries, and their work in this field was largely responsible for the remarkable development of German overseas' trade. German banks not only established subsidiary banks, but in many instances obtained controlling interests in native institutions, giving them a large measure of command of foreign banking transactions.

No matter what we may think of the Germans, it is generally conceded that their preparations for the commercial conquest of the world were quite complete, and not the least important of these preparations was the concentration of their banking and credit powers into a few large institutions. The two largest of these show deposits, according to the last available figures, approximately as follows:

Deutsche Bank	$2,250,000,000
Disconto Gesellschaft	1,100,000,000

Germany's evident mistake was in trying to hasten its conquest by force of arms which it was gradually achieving by the weapons of peace.

The question also of the desirability of extending our financial spheres of influence at home may well be raised in order to meet the growing necessity for financing large undertakings to an extent quite out of proportion to the resources of smaller institutions, and consequently unsafe for them. Such service would be possible through the "big" bank with affiliated interests or branches, which might not otherwise be rendered.

For the first time in the history of the United States, we have the opportunity of becoming a factor in international trade and finance. Our weaknesses are many. A banking system concentrated under one head, properly organized to meet the demands of different localities with larger institutions ready to meet the competition of the large concentration of credit in Europe and Germany may prove necessary.

One of the English writers in discussing this situation says:

"The money-lenders in the Temple, the Venetian and Genoese banks, the Lombards, the Goldsmiths, and the 'Jingling Geordies' each fulfilled the needs of their periods, but they would all be anachronisms at the present time. For the same reason the private banker—adequate as he was to his generation—could not possibly finance the trade of this country under present conditions. Indeed, even in his heyday his lack of strength brought ruin and misery to many homes. He was inadequate, and because of this, and this alone, he was superseded. Size is, after all, only a relative matter, and each succeeding generation is staggered by comparing things as they are with things as they were. At the moment the banking system is in the midst of a period of transition. For centuries it has evolved and adjusted itself to meet the needs of passing periods, and at the present time it is engaged in making such adjustments as are necessary to provide our traders with identical or better facilities than those supplied to their competitors by the mammoth institutions existing abroad.

"Rome was not built in a day, and the perfected banking machinery necessary to the great 'after-the-war' trade effort cannot be created at a few hours' notice. Imperfections will no doubt be discovered, but that they will be remedied is guaranteed by the fact that the large majority of distinguished bankers —whether general managers or directors—have identified themselves with the policy now being pursued."

Expanding Our Vision

In the natural evolution of banking in this country, it is quite certain that our vision must extend beyond the State,—beyond the nation,—out into the world at large. Branches of American banks are being opened in foreign countries from time to time; and not only American finance, but American merchant marine and commerce, will be greatly promoted thereby—and, with the coöperation of our authorities in Washington, the development of our interest in foreign trade and industry may at this psychological moment be most rapid.

We must adjust our minds not only to the expansion of our own banking interests abroad, but perhaps even to coöperation with foreign banks in some international banking plan which will meet the exigencies forced upon us by the war. With half of the world on a paper basis, it is certain that some international banking agreement must be worked out if we are to stabilized the world's tokens of exchange, and expedite the trade of nations.

It seems important that private initiative and enterprise should be given the widest possible latitude in this field, in keeping with the public interest.

It seems equally important to me that Governmental activities be restricted to the support of such enterprise, rather than to supplanting it. For instance, the original proposition to organize a foreign exchange bank in connection with our Federal Reserve System seemed to be unnecessary, as our present banking system is providing for these needs with greater efficiency and less expense than would be possible through any Government agency.

No Governmental financial institution should be projected into the field of competition with privately owned banks. The Government's function here is that of providing a reservoir of credit for the assistance of the banks, and any innovation which would change that relation appears unwise and unjustified.

If it could be proved that a foreign trade bank could be organized as a Government agency free from such objections, which would act as a service institution in coöperation and not in competition with private banks, it might be worthy of consideration, providing special care is taken in working out its details in order to avoid conflicting interests which might retard the development of our foreign trade.

It is certain that we shall need united effort to meet the competition we shall face, and in lieu of a branch-banking system and banking amalgamations, American banks must work together on a basis of common interest and in the general interest.

With courage we must face the future, confident that with a better understanding of our local and National problems, and with a closer and more sympathetic coöperation between the governing authorities and financial institutions, continuing progress will be assured. These are not the times for jealousies, prejudices or selfishness, but with largeness of heart and bigness of vision we must unite in a common effort to help America achieve its manifest destiny.